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E.O. 12958: N/A

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SUBJECT: PIKALYOVO'S DILEMMA UNRESOLVED: COMPANIES KICK THE CAN FURTHER DOWN THE ROAD

REF: ST PETERSBURG 68, ST PETERSBURG 89

¶1. (U) Summary. Companies involved in the controversy surrounding the industrial complex in the town of Pikalyovo, Leningrad oblast, have agreed to extend until the end of 2009 the agreements PM Putin forcefully persuaded them to sign in June during a visit there. The extension will allow the industrial complex to continue working over the next four months, keeping a lid on social tensions there for the time being. However, the stop-gap solution fails to resolve the underlying challenge of how to restructure the town's industry in order to make it competitive and self-sustaining in the absence of state intervention. End Summary

¶2. (U) According to the press service of the federal Ministry of Industry and Trade, the companies involved in the controversy surrounding the industrial complex in Pikalyovo in Leningrad Oblast (reftels) decided to prolong until the end of the current year the agreements PM Putin forcefully persuaded them to sign in June during his visit to the town. That decision was adopted on August 28 at a meeting of the federal "Pikalyovo Task Force" led by Deputy Minister of Industry and Trade Denis Manturov. Based on the Federal Antimonopoly Service's (FAS) recommendations, prices for raw materials used in Pikalyovo's industrial production have been slightly revised under the extended agreement.

¶3. (U) According to the FAS, the slight revision in raw materials prices will allow the production complex in Pikalyovo to operate through the end of the year without incurring losses. However, the local press has reported that outside experts claim that the agreement saddles Apatit, the Murmansk Oblast-based supplier of raw materials for Pikalyovo's Bazeltsement industrial firm, with the bulk of the burden of the agreement, since it will have to continue selling materials to Bazeltsement at cut-rate prices. (Note: Despite the public hammering oligarch Oleg Deripaska - a Putin confidant and owner of one of the factories in the Pikalyovo complex - took from Putin during the PM's visit there in June, the price revisions give Deripaska's company a continued artificial edge over the competition, which does not enjoy the same pricing advantages. End note.)

¶4. (U) Murmansk-based Apatit has not yet signed onto the new agreement, claiming that the new price of 850 rubles per ton of output is still far below its production cost. It has agreed to accept the 850 ruble price only for the next two months, and has proposed adding a penalty cost of another 350 rubles per ton if Bazeltsement fails to consume the agreed-upon volumes of the product. Press reports that although both Evrotsement and Metahim, the other two plants in Pikalyovo, have signed the new agreement, they have also submitted letters of protest to Bazeltsement and to the Ministry of Industry and Trade stating their disagreement with some of the contracts' conditions.

¶5. (U) Comment: In the meantime, the companies concerned are required by the new agreement to continue negotiations aimed at producing a new organizational structure and sustainable long-term pricing system for Pikalyovo's industrial complex. A new round of talks on that subject has been scheduled for the

end of September. In the absence of such a solution, we are likely to see continued stop-gap measures meant to prevent a production stoppage which could threaten social stability in Pikalyovo, an outcome the government seems determined to prevent at any cost. End comment.

GWALTNEY